

**ORANGE COUNTY  
TRANSPORTATION AUTHORITY  
Orange, California**

Single Audit Report on  
Federal Awards

Year Ended June 30, 2008

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# ORANGE COUNTY TRANSPORTATION AUTHORITY

## Single Audit Report on Federal Awards

Year Ended June 30, 2008

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Board of Directors  
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Orange, California

**REPORT ON COMPLIANCE AND OTHER MATTERS AND ON INTERNAL CONTROL OVER  
FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS  
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

We have audited the financial statements of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the Orange County Transportation Authority (OCTA), as of and for the year ended June 30, 2008, which collectively comprise OCTA's basic financial statements and have issued our report thereon dated October 24, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered OCTA's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of OCTA's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of OCTA's internal control over financial reporting.

Our consideration of the internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily disclose all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects OCTA's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of OCTA's financial statements that is more than inconsequential will not be prevented or detected by OCTA's internal control. We consider items 08-01 through 08-04 as



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described in the accompanying Schedule of Findings and Questioned Costs to be significant deficiencies in internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by OCTA's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all the deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether OCTA's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted other certain matters we reported to the management of OCTA in a separate letter dated October 24, 2008.

OCTA's written responses to the significant deficiencies identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit OCTA's responses, and accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Board of Directors and management of OCTA and is not intended to be and should not be used by anyone other than these specified parties.

*Mayer Hoffman McCann P.C.*

Irvine, California  
October 24, 2008



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**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH  
MAJOR PROGRAM, INTERNAL CONTROL OVER COMPLIANCE AND ON  
THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
IN ACCORDANCE WITH OMB CIRCULAR A-133**

Compliance

We have audited the compliance of the Orange County Transportation Authority (OCTA) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its major federal programs for the year ended June 30, 2008. OCTA's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal programs are the responsibility of OCTA's management. Our responsibility is to express an opinion on OCTA's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about OCTA's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of OCTA's compliance with those requirements.

In our opinion, OCTA complied, in all material respects, with the requirements referred to above that are applicable to its major federal programs for the year ended June 30, 2008. However, the results of our auditing procedures disclosed one instance of noncompliance with those requirements, which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned costs as item 08-05.



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#### Internal Control Over Compliance

The management of OCTA is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered OCTA's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of OCTA's internal control over compliance.

A control deficiency in OCTA's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects OCTA's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by OCTA's internal control. We consider the deficiency in internal control over compliance described in the accompanying schedule of findings and questioned costs as item 08-05 to be a significant deficiency.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by OCTA's internal control.

Our consideration of the internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

#### Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of OCTA as of and for the year ended June 30, 2008, and have issued our report thereon dated October 24, 2008. Our audit was performed for the purpose of forming our opinions on the financial statements that collectively comprise OCTA's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic



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financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

OCTA's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit OCTA's responses, and accordingly, we express no opinion on them.

This report is intended for the information and use of the Board of Directors, management of OCTA, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*Mayer Hoffman McCann P.C.*

Irvine, California

December 12, 2008, except for the Schedule of Expenditures of Federal Awards, as to which the date is October 24, 2008

**ORANGE COUNTY TRANSPORTATION AUTHORITY**

Schedule of Expenditures of Federal Awards

Year Ended June 30, 2008

Federal Grantor/ Pass-through Grantor/ Program Title	Federal Domestic Assistance Number	Program Identification Number	Federal Financial Assistance Expenditures	Amount Provided to Subrecipients
<b><u>U.S. Department of Transportation</u></b>				
Direct Assistance:				
Federal Transit Cluster:				
Federal Transit - Capital Investment Grants	20.500		\$ 3,284,001 *	3,094,739
Federal Transit - Formula Grants	20.507		96,759,533 *	3,625,272
Total Federal Transit Cluster			<u>100,043,534</u>	<u>6,720,011</u>
State Planning and Research	20.515		28,234	-
Passed through California Department of Transportation:				
Highway Planning and Construction	20.205	CMLN-6071(023)	15,225,358	-
Total U.S. Department of Transportation			<u>115,297,126</u>	<u>-</u>
<b><u>U.S. Department of Homeland Security</u></b>				
Passed through State of California				
Office of Emergency Services:				
Rail and Transit Security Grant Program	97.075		1,324,263	-
Office of Emergency Services	97.036		16,169	-
Total U.S. Department of Homeland Security			<u>1,340,432</u>	<u>-</u>
<b><u>U.S. Department of Health and Human Services</u></b>				
Passed through County of Orange				
Community Services Agency:				
Special Programs for the Aging - Title III, Part B - Grants for Supportive Services and Senior Centers	93.044	22-0203	337,270	-
Total U.S. Department of Health and Human Services			<u>337,270</u>	<u>-</u>
Total federal expenditures			\$ <u>116,974,828</u>	\$ <u>6,720,011</u>

\* Major Programs

See Notes to Schedule of Expenditures of Federal Awards



# ORANGE COUNTY TRANSPORTATION AUTHORITY

## Notes to Schedule of Expenditures of Federal Awards

Year Ended June 30, 2008

(1) **Summary of Significant Accounting Policies Applicable to the Schedule of Expenditures of Federal Awards**

(a) **Scope of Presentation**

The accompanying schedule presents only the expenditures incurred by the Orange County Transportation Authority (OCTA) that are reimbursable under federal programs of federal financial assistance. For the purpose of this schedule, federal financial assistance includes both federal financial assistance received directly from a federal agency, as well as federal funds received indirectly by OCTA from a non-federal agency or other organization. Only the portion of program expenditures reimbursable with such federal funds is reported in the accompanying schedule. Program expenditures in excess of the maximum federal reimbursement authorized or the portion of the program expenditures that were funded with state, local or other non-federal funds are excluded from the accompanying schedule.

(b) **Basis of Accounting**

The expenditures included in the accompanying schedule were reported on the modified accrual basis of accounting. Under the modified accrual basis of accounting, expenditures are recognized when OCTA becomes obligated for payment as a result of the receipt of the related goods and services. Expenditures reported include any property or equipment acquisitions incurred under the federal program.

(c) **Subrecipients**

OCTA made payments to subrecipients totaling \$6,720,011 during the fiscal year ended June 30, 2008.

# ORANGE COUNTY TRANSPORTATION AUTHORITY

## Schedule of Findings and Questioned Costs

Year Ended June 30, 2008

### **(A) Summary of Auditor's Results**

1. An unqualified report was issued by the auditors on the financial statements of the auditee.
2. The audit disclosed four significant deficiencies in internal control over financial reporting.
3. The audit disclosed no noncompliance which is material to the financial statements of the auditee.
4. There was one significant deficiency and no material weaknesses in internal control over the major programs of the auditee.
5. An unqualified report was issued by the auditors on compliance for major programs.
6. The audit disclosed no audit findings required by the auditors to be reported under paragraph .510(a) of OMB Circular A-133.
7. The major programs of the auditee were CFDA No. 20.500, U.S. Department of Transportation – Federal Transit – Capital Investment Grants and CFDA No. 20.507, U.S. Department of Transportation – Federal Transit – Formula Grants.
8. The dollar threshold used to distinguish Type A and Type B programs was \$3,509,245.
9. The auditee did not meet the criteria to be considered a low risk auditee for major program determination for the year ended June 30, 2008.

### **(B) Findings Related to the Financial Statements which are Required to be Reported in Accordance with Generally Accepted Government Auditing Standards (GAGAS)**

#### **(08-01) Need to Strengthen Controls of Third-Party Contractor**

OCTA utilizes a third-party contractor (contractor) to manage and oversee the State Route 91 Toll Road (Toll Road) revenue cycle. The information systems of the contractor are significant to the financial information of OCTA. As such, we reviewed the information systems of the contractor to ensure that controls were designed and implemented to mitigate risk of loss of OCTA assets. During this review, we noted the following issues:

# ORANGE COUNTY TRANSPORTATION AUTHORITY

## Schedule of Findings and Questioned Costs

(Continued)

**(B) Findings Related to the Financial Statements which are Required to be Reported in Accordance with Generally Accepted Government Auditing Standards (GAGAS) (Continued)**

**(08-01) Need to Strengthen Controls of Third-Party Contractor (Continued)**

- Tape backups of all files, including master files, transaction files, application programs, systems software, and database software that support Toll Road operations, are currently stored on-site at the third-party contractor's office. The contractor has elected to maintain tape backups onsite based on current business concerns. Industry best practice recommends using a backup storage site that is geographically removed from the primary site. In the event of a catastrophic event at the main office location, information would be lost without a means for recovery.
- The system used to track customer account and vehicle information has password controls that are limited to a minimum of 6 characters, with no complexity requirements or user lockout after a certain number of unsuccessful log-in attempts. Effective password complexity controls were not considered during system implementation. Controls recommended by industry best practice include:
  - a. Alphanumeric passwords;
  - b. Required password change interval; and
  - c. Locking user accounts after a maximum number of incorrect password attempts.

Without effective password controls, an unauthorized user could employ various forms of password hacking tools to access the system.

- The process to remove terminated employees from systems is manual and not synchronized to a master employee database. In addition, of the 5 terminated users sampled, one user was not removed from the active directory network in a timely manner. Industry best practice suggests removing user access to systems immediately following termination. Untimely removal of users' access after termination provides employees an opportunity to sabotage or otherwise impair entity operations or assets.

The aggregate effect of these weaknesses in information systems controls increases the likelihood of theft, loss or misuse of OCTA assets.

# ORANGE COUNTY TRANSPORTATION AUTHORITY

## Schedule of Findings and Questioned Costs

(Continued)

**(B) Findings Related to the Financial Statements which are Required to be Reported in Accordance with Generally Accepted Government Auditing Standards (GAGAS) (Continued)**

**(08-01) Need to Strengthen Controls of Third-Party Contractor (Continued)**

**Recommendation**

We recommend that the third-party contractor be required to establish procedures to strengthen internal controls in the information systems associated with the OCTA contract.

**Management's Responses**

Staff agrees with the auditors' recommendation regarding backup tapes. The Authority's operator, Cofiroute USA (Cofiroute), had been maintaining backup tapes at the Anaheim Office for research purposes related to ongoing litigation against the Authority. However, all backup tapes have now been stored at a secure, offsite location with Iron Mountain.

Staff agrees with the auditors' recommendation regarding password controls. For Cofiroute employees to access the system used to track customer account and vehicle information, TollPro, requires the user to first login to the domain. Cofiroute controls access to the domain. The password complexity for the domain is as follows:

- a. The password cannot contain all or part of the user's account name
- b. The password must be at least seven characters in length
- c. The password must contain characters from three of the following four categories:
  - English uppercase characters (A through Z)
  - English lowercase characters (a through z)
  - Base 10 digits (0 through 9)
  - Non-alphanumeric characters (&, \$, #, %, etc.)
- d. The user is automatically logged off if the domain is not accessed for 10 minutes
- e. After five invalid logon attempts, the account will be locked out.

Once the domain is accessed, the user must then enter a TollPro password. The TollPro system currently does not have the password complexity requirements identified above with the Cofiroute login procedures. The system developer of TollPro, Northern Lakes Data Corporation, will be modifying the password complexity to match industry best practices.

# ORANGE COUNTY TRANSPORTATION AUTHORITY

## Schedule of Findings and Questioned Costs

(Continued)

**(B) Findings Related to the Financial Statements which are Required to be Reported in Accordance with Generally Accepted Government Auditing Standards (GAGAS) (Continued)**

**(08-01) Need to Strengthen Controls of Third-Party Contractor (Continued)**

Staff agrees with the auditors' recommendation of removing user access to systems immediately following termination. Cofiroute's practice is to remove employees by the end of the following business day for terminated employees. In the example cited in the finding, an employee was terminated on the Friday prior to the Thanksgiving week of 2007. The Human Resources employee responsible for removing terminated employees was on vacation during that week. Therefore, the terminated employee was not removed from the system until the following Monday, ten days after the day of termination. Cofiroute will implement a policy to ensure all terminated employees are removed by the close of the following business day.

Cofiroute is an independent contractor responsible for managing 91 Express Lanes operations for the Authority. The TollPro system that is used to track customer account and vehicle information is a proprietary system developed and maintained by Northern Lakes Data Corporation and is not connected to the Cofiroute management system or Human Resources records. Cofiroute maintains Human Resources data at its corporate office in Irvine. TollPro and Cofiroute systems are completely independent and not technically compatible. Cofiroute does not permit access of the TollPro system from computers other than those owned by the 91 Express Lanes. Cofiroute employees can only access TollPro through a Cofiroute controlled computer and domain.

**(08-02) Internal Controls over the Combined Transportation Funding Program**

During our search for unrecorded liabilities, we noted two cash disbursements related to Combined Transportation Funding Program (CTFP) Agreements between OCTA and the City of Anaheim (City) that should have been accrued at June 30, 2008.

According to Project Delivery Department personnel, the cash disbursements were not issued to the City during fiscal year 2007-08 as the required documentation was furnished to OCTA subsequent to year-end. However, all of the supporting documentation submitted to OCTA was dated January 2008. As a result, the Accounting Department posted an adjustment for \$6,375,355 to accrue this liability as of June 30, 2008.

**Recommendation**

We recommend that the Project Delivery Department ensure proper documentation is maintained regarding any withholding or delay of payments resulting from lack of documentation provided by the entity awarded CTFP funds.

# ORANGE COUNTY TRANSPORTATION AUTHORITY

## Schedule of Findings and Questioned Costs

(Continued)

**(B) Findings Related to the Financial Statements which are Required to be Reported in Accordance with Generally Accepted Government Auditing Standards (GAGAS) (Continued)**

**(08-02) Internal Controls over the Combined Transportation Funding Program (Continued)**

**Management's Response**

Staff is currently developing an electronic tracking system that will facilitate the audit recommendation. This effort was in process prior to the audit report. Once completed, the system will provide an electronic log of invoice issues, missing documentation, correspondence with the cities, and track the dates missing documentation is both requested and received.

**(08-03) Communication of Financial Information to the Appropriate Department**

During our review of fund balances, we noted one instance where revenues related to cooperative agreements entered into by OCTA were improperly accrued in prior years and had to be adjusted in the current year. The amount of the prior year adjustment was \$4,114,302. The primary cause of this was a lack of communication of changes in cooperative agreements by project managers to the Financial Planning and Analysis Department (FP&A) or the Accounting Department. The cooperative agreement changes and amendments appear to involve OCTA's Planning Department, which does not always communicate amendments to agreements to FP&A and Accounting.

**Recommendation**

We recommend OCTA establish procedures or protocols to ensure that all information of a financial nature is communicated to the FP&A Department or Accounting Department, as appropriate.

**Management Response**

This was a unique situation that is unlikely to be repeated. The original cooperative agreement with Caltrans referred to the "latest revision" of a standard funding agreement as the appropriate documentation for the subject funding amount. This funding agreement was revised a couple of times, but a change to the document did not require the original cooperative agreement to be amended. If an amendment were to be made to the agreement, it would have been transmitted to FP&A by the Contracts Administration and Material Management (CAMP) Department. This was an unusual structure for a cooperative agreement that is unlikely to be repeated. The normal processing and transmittal of agreements and amendments by CAMP should provide the required financial information needed by FP&A.

# ORANGE COUNTY TRANSPORTATION AUTHORITY

## Schedule of Findings and Questioned Costs

(Continued)

**(B) Findings Related to the Financial Statements which are Required to be Reported in Accordance with Generally Accepted Government Auditing Standards (GAGAS) (Continued)**

**(08-04) Need to Establish a Policy on Misconduct**

OCTA does not currently have a written policy on misconduct. An effective method of communicating and reinforcing an antifraud culture within an organization is through the development of a policy on misconduct. A misconduct policy communicates to all employees the organizational position and policy on matters such as the following:

- Risks that the organization faces from fraud, abuse and other forms of misconduct;
- Effect of the Code of Conduct;
- Definitions of misconduct, including fraud and abuse;
- Employee's responsibility to report suspected misconduct (including an established reporting mechanism, such as a member of the Board of Directors, a consultant or advisor, hotline service, etc.);
- Organizational responsibility to investigate; and
- Disciplinary action for violations

Best practice suggests that a misconduct policy and its annual reaffirmation by employees will greatly strengthen internal controls to prevent the occurrence of fraud and abuse. The policy should be acknowledged and signed by each employee upon hire and on an annual basis as evidence of their affirmation that they understand the policy and have complied with its provisions. This condition was also reported for the year ended June 30, 2007 in our communication dated October 31, 2007.

**Recommendation**

OCTA should develop and implement a policy on misconduct. Once developed, the policy should be acknowledged and signed by each employee on an annual basis as evidence of their affirmation that they understand the policy and have complied with its provisions.

**Management Response**

Management will develop and implement a policy on misconduct; each new hire will be asked to acknowledge and sign the policy upon starting work at OCTA.

# ORANGE COUNTY TRANSPORTATION AUTHORITY

## Schedule of Findings and Questioned Costs

(Continued)

**(C) Findings and Questioned Costs for Federal Awards as Defined in Paragraph .510(a) at OMB Circular A-133**

**(08-05) Need to Adhere to Buy America Requirements**

OCTA's rolling stock procurement documentation did not meet the Post-Delivery Procurement Audit requirements per the Federal Transit Administration (FTA) Buy America Handbook. According to Section 3 of the Buy America Handbook, purchases of 10 buses or more must have the resident inspector complete a final manufacturing report, which should include any information that supports or refutes claims made by the manufacturer concerning its capabilities or the bus specifications. For buses manufactured in multiple stages (such as body-on-chassis buses), the resident inspector is required to visit the final-stage manufacturer's final assembly location only. Once completed, the Post-Delivery Purchaser's Requirement Certification is made and filed.

OCTA provided the sign-off of contract completion as proof of the post-delivery review for the rolling stock purchases reviewed. However, the documentation does not provide sufficient evidence that OCTA verified that the Buy America information had not materially changed from the pre-award stage to the completed manufacturing stage. This condition was also reported for the year ended June 30, 2007 in our communication dated October 31, 2007.

**Recommendation**

We recommend that OCTA adhere to the Buy America requirements and ensure that all documentation is contained in the procurement files to support OCTA's compliance.

**Management Response**

The OCTA Transit Division Maintenance Department inspectors will follow the Buy America guideline as done last year. OCTA will insure that contract administration has the necessary paperwork on file for the closing of contracts for the post filings.



# ORANGE COUNTY TRANSPORTATION AUTHORITY

## Summary Schedule of Prior Audit Findings

Year Ended June 30, 2008

### Status of Prior Year Audit Findings:

- (07-01) Need to Establish a Policy on Misconduct - See current year finding 08-04
- (07-02) Need to Strengthen Procurement Procedures over On-Call Contracts - Resolved
- (07-03) Internal Controls over Bus Pass Inventory – Resolved
- (07-04) Need to Establish a Formal Change Management Process - Resolved
- (07-05) Lack of Segregation of Duties Over Assignment of Permissions within IFAS – Resolved
- (07-06) Accounts Payable Cutoff Needs to be Adhered to – Resolved
- (07-07) Need to Improve Subrecipient Monitoring Procedures – Resolved
- (07-08) Need to Adhere to Buy America Requirements – See current year finding 08-05